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Before the

**Federal Communications Commission  
Washington, D.C. 20554**

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OFFICE OF THE SECRETARY

**In the Matter of**

**Federal-State Joint Board on  
Universal Service**

**Access Charge Reform**

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**CC Docket No. 96-45**

**CC Docket No. 96-262**

**COMMENTS OF MCI WORLDCOM, INC.**

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List A B C D E

## **Table of Contents**

Executive Summary .....	-i-
I. Introduction .....	-1-
II. Background .....	-2-
III. Fundamental Problems with the Funding Mechanism in the Order Should Be Addressed Before Turning to the Implementation Issues .....	-5-
IV. Further Comment Is Needed to Remedy the Absence of Record Evidence in Support of the Proxy Measures .....	-7-
V. Key Parameters in the Commission Funding Mechanism Are Inherently Subjective ...	-9-
VI. The Structure of the Funding Mechanism Unnecessarily Builds in Subjectivity and Focuses on Providers Rather than Customers .....	-10-
VII. Relative Costs Are Not a Good Proxy Measure of Comparable Rates .....	-11-
VIII. The Funding Mechanism Does Not Provide a Framework to Transition to Competition or Eliminate Implicit Subsidies .....	-12-
IX. A “Hold Harmless” Policy Will Undermine Competitive Neutrality .....	-14-
X. The Choice of Geographic Area Will Have Unintended Significant Impacts on Competitive Neutrality, Efficient Investment Decisions, and Targeting Universal Service Funds .....	-15-
XI. In the Absence of Comprehensive Universal Service and Access Charge Reform, Partial Steps Should Be Taken to Remove Implicit Universal Service Subsidies from Interstate Access Charges, Starting with Carrier Common Line Charges .....	-17-
XII. Simulations Show That Commission’s Model Is a Blunt, Inflexible, Instrument, Incapable of Achieving its Stated Goals in a Rational Manner .....	-18-
XIII. Conclusion .....	-19-

## **Executive Summary**

In this Order and Further Notice the Commission adopts broad revisions to federal universal support as part of its mandate to develop support mechanisms that are specific, predictable, and sufficient and that ensure that consumers in high cost areas have access to telecommunications services at rates that are affordable and reasonably comparable to rates charged for similar services in urban areas.<sup>1</sup> In order to comply with its mandate to establish reasonably comparable and affordable rates the Commission must simultaneously identify the source and magnitude of implicit subsidies, and establish procedures that eventually replace implicit subsidies with explicit ones.<sup>2</sup> The Order and Further Notice fail to do this.

An essential step in comprehensive universal service reform is to define and measure the universal service support needed to ensure affordable and comparable rates. Unless the total subsidy needed is actually calculated, it will be impossible to identify the magnitude of implicit subsidies. Unless the source and size of implicit subsidies are identified, it will be impossible to determine when competition will threaten implicit subsidies and when and where to implement a regime of explicit subsidies. Unless subsidies are made explicit it will be difficult, if not impossible, for universal service support to be available to all carriers in a competitively-neutral fashion. The Commission should use the Further Notice part of the proceeding to establish a substantive record needed to perform comprehensive universal service and access reform.

The Order and Further Notice fail to properly measure comparable rates. The

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<sup>1</sup> 47 U.S.C. § 254(b)(3)(4).

<sup>2</sup> 47 U.S.C. § 254(e).

Commission adopted the Joint Board's definition of comparable rates, but that recommendation was made without any supporting evidence in the record. No one has, for example, documented the connection between state-wide average costs and rates. Neither do alternative measures of comparability exist in the record. The Commission should use the Further Notice part of the proceeding to establish a record that examines the reliability and feasibility of its comparability measure, and compare these results with alternate measures of comparable rates.

In short, the Order and Further Notice derive funding mechanisms based on inherently subjective variables. The Commission has no objective basis for choosing the values for two key variables in its funding mechanism: threshold cost differential percentage; and the level or percentage of per line revenues that states can be expected to contribute toward funding rate comparability support. For example, it fails to consider the different revenue generating possibilities of business lines from residential lines. The subjective, *ad hoc*, determination of the size of these key variables, as well as their interaction, will actually limit the ability of the Commission to flexibly respond to the erosion of implicit subsidies should effective competition actually develop, since competition will not develop in a uniform fashion across states.

Finally, the Commission should not adopt any hold harmless clauses since they undermine competition by artificially favoring incumbents. If a carrier were held harmless, then it would continue to receive the same level of universal service funding even if it were no longer serving all the high-cost customers whose rates the universal service fund was intended to keep affordable and comparable. This state of affairs would violate Section 254(e) of the Act, which requires federal support to be used "only for the provision, maintenance, or upgrading of facilities and services for which the support was intended."



## **I. Introduction**

In its Further Notice relating to a universal service fund for high cost areas served by non-rural local exchange carriers,<sup>3</sup> the Federal Communications Commission (“Commission”) seeks comment on “specific implementation issues” associated with creating an interstate fund to help maintain rates in high cost areas reasonably comparable with rates in urban areas. In the Order, the Commission determined that a new interstate fund should be created, and identified a new funding mechanism with key elements based on the recommendations in the Joint Board’s Second Recommended Decision. In the Further Notice, the Commission limited the range of issues for which it seeks comment primarily to the values or scope of several input variables incorporated in the new funding mechanism.

Although the Order states at paragraph 3 that “we adopt broad revisions to the federal support mechanisms, in light of the Joint Board’s most recent recommendations, to permit rates to remain affordable and reasonably comparable across the nation...,” in paragraph 30 the Order states that “The Joint Board and the Commission have concluded that current rate levels are affordable.” Consistent with that conclusion, the Order appears to assume that no additional interstate funding is needed to meet the goal of rate affordability. The funding mechanism presented in the Order appears to address rate comparability only. The Order, however, fails to identify whether local rates have been kept affordable in part by implicit universal service support in current interstate access charges or whether there are no such implicit “affordability” subsidies

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<sup>3</sup> Federal State Joint Board on Universal Service, CC Docket No. 96-45 and Access Charge Reform CC Docket No. 96-262, Further Notice of Proposed Rulemaking and Seventh Report & Order and Thirteenth Order on Reconsideration in Docket No. 96-45, and Fourth Report and Order in CC Docket No. 96-262, released May 28, 1999 (hereinafter “Further Notice” or “Order”).

in interstate access charges; nor does it provide any guidance on how to make such an identification. Fundamentally, the Order fails to achieve the requirements of the Telecommunications Act of 1996.

Assuming the Commission wants to pursue its flawed plan to implementation, it needs to back up a half step to seek substantive record evidence sufficient to provide a conceptual basis for the universal service “solution” announced in the Order. It also needs to ask some basic questions, which have so far been overlooked, in its further consideration of implementation issues. MCI WorldCom advocates that the Commission use this Further Notice stage of the proceeding to open the record more broadly to these critical issues. In our comments, below, MCI WorldCom specifically identifies the record problems that can and must be remedied before a final decision is reached.

## **II. Background**

As the Commission articulated in its First Report and Order implementing the local competition provisions of the Telecommunications Act of 1996, proper implementation of the Act requires coordinated action on three fronts — implementation of rules for local competition, comprehensive universal service reform, and access charge reform — to create a new regulatory framework for the transition from monopoly to competitive telecommunications markets.<sup>4</sup> The partial universal service reform presented in the Order, which attempts to address a narrow universal service issue by adhering to the old regulatory paradigm, is antithetical to the

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<sup>4</sup> In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket No. 95-185, First Report and Order, released August 8, 1996, at para. 6.

comprehensive reform required by the Act.

To fully execute the Act, the amount of subsidy necessary to keep rates affordable and comparable must be identified. Then regulators must create a competitively-neutral fund so that all eligible carriers may offer local service and receive universal service funding to the extent they serve high cost customers. Finally, since universal service subsidies are embedded in today's rate structure, there must be a dollar for dollar reduction in existing incumbent local exchange carrier rates in order to avoid placing a double burden on interexchange carriers and their customers and to eliminate ILEC double-recovery of universal service costs. In MCI WorldCom's views, access charges are a major source of today's implicit subsidy flows. Unfortunately, the Order and Further Notice stray from these requirements.

The Commission's approach is very different. The interstate funding mechanism in the Order compares a proxy for the funding needed to ensure reasonably comparable rates to a proxy for each state's ability to contribute toward rate comparability, thereby yielding the amount of additional interstate funds allegedly needed by each state.

The first part of the Commission's new funding mechanism, the proxy measure of reasonably comparable rates, does not look at actual rates to determine whether they are reasonably comparable, but rather assumes that rates are related to costs and employs a comparison of state-specific costs to nationwide average costs as a proxy for the relative rate level in a state. The forward-looking cost per line in a geographic area<sup>5</sup> is compared to the

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<sup>5</sup> The Commission seeks comment (at para. 102) on the scope of the geographic area for which the cost estimate should be performed, i.e., whether the geographic area should be (1) the entire study area, (2) the area corresponding with the geographic cost zone used for loop rate deaveraging, or (3) the serving wire center.



nation-wide average forward-looking cost per line. If that differential exceeds a threshold percentage,<sup>6</sup> it is assumed that the rates for that geographic area will not be reasonably comparable without subsidy support. An interstate fund would be created to support all costs above the threshold less those costs that the Commission determines could be supported by the states.

The second part of the Commission's new funding mechanism is a proxy measure of a state's ability to support the costs associated with maintaining reasonable comparable rates in the high cost areas in the state. (This amount is subtracted from the estimate of total support needed to determine how much interstate funding the state requires.) The Commission's proxy is simply a fixed amount of money per line times the number of lines in the state. The Commission seeks comment (at para. 111) on what the per line contribution from states should be. In the Order it concludes that this amount should be fixed per line across all states, but asks if the per line contribution should be calculated by taking the \$31 residential revenue benchmark the Commission tentatively adopted in its First Report & Order<sup>7</sup> and multiply it by some portion — perhaps 3 to 6 percent — to yield an approximately \$1 to \$2 state contribution.

In the Further Notice, the Commission couches its request for input on what the values should be for these variables in terms of whether and how the values can be chosen to yield a small explicit fund, based on its finding that in today's market environment, with the lack of competition, the implicit universal service subsidies in above-cost rates are not threatened by

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<sup>6</sup> The Commission seeks comment (at para. 97) on what that threshold percentage should be.

<sup>7</sup> In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order (First Report Order), Released May 8, 1997.

erosion and therefore only a small explicit fund is needed. The Commission specifically requests commenters to plug their choice of values for the variables into its cost model to show how those choices would yield the small fund it envisions. The Commission also seeks comment on whether there should be a hold harmless clause to ensure that no individual state and/or carrier receives less funding under the new mechanism than it does currently.

### **III. Fundamental Problems with the Funding Mechanism in the Order Should Be Addressed Before Turning to the Implementation Issues**

MCI WorldCom finds it very difficult to respond to many of the requests for comment in the Further Notice because the Further Notice primarily seeks input on the values to use for variables for which there are no analytically or objectively correct values. As explained below, the variables do not substantively measure the public policy parameters for which they are intended to be proxies. Any values chosen for these variables are inherently subjective and the resulting estimates of the level of universal service support needed will have neither an analytical nor a public policy foundation. The variables' only "merit" is that their values can be manipulated to yield an estimated "need" for whatever level of funding is being sought. It would be a much more meaningful public policy exercise to seek comment on whether the funding mechanism adopted in the Order accurately defines, measures, and provides the universal service support needed for affordable and reasonably comparable rates (as required by Section 254(b) of the Act) and ensures that any "carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended" (as required by Section 254(e) of the Act). A critical part of this exercise should be to collect evidence that shows whether the proxy measures incorporated in the Order's funding mechanism

accurately measure the public policy parameters they are intended to measure — rate comparability and the ability of a state to provide funding to support costs associated with maintaining reasonably comparable rates in the state. Unfortunately, despite the total lack of record evidence, the Order adopts a funding mechanism and only seeks input on the values for variables that offer no insight into the public policy parameters that are the objective of the Act. The Commission has created a fact-free environment in which it believes it will be able to justify any course it chooses by manipulating the values for these input variables.

MCI WorldCom also is troubled by the short-term and piecemeal approach taken by the Order and Further Notice. The Commission is correct that there currently is virtually no competitive pressure on the implicit subsidies. But the Act requires the Commission to undertake comprehensive universal service reform of the sort proposed in the First Report and Order — defining and calculating the total universal service subsidy need, creating an explicit fund to meet that need, and concurrently removing existing implicit universal service subsidies from interstate access charges. A “solution” that does not identify and calculate the total universal service funding need, but rather maintains unidentified and unmeasured levels of funding embedded in rates that are potentially subject to competitive erosion, harms the marketplace by unnecessarily maintaining a high level of government-induced uncertainty. If the Commission (based on advice from the Joint Board) believes that competition has not yet developed that would erode the implicit subsidies in existing rates and that complete shift to explicit funding is not needed today, then it might choose to delay fully replacing implicit subsidies with explicit ones, but it still has a legal requirement to identify the solution now. If the Commission believes that affordable or reasonably comparable rates could be threatened in the future by the advent of competition, it

must provide guidance on how the universal service funding mechanism will accommodate such competitive developments — how it will provide the solution. But the Order and Further Notice fail to identify the level of implicit subsidies currently supporting affordable and reasonable comparable rates. Simply put, the mechanism pursued in the Further Notice has no objective way to measure what the additional need will be if and when competition develops.

#### **IV. Further Comment Is Needed to Remedy the Absence of Record Evidence in Support of the Proxy Measures**

In the Order, the Commission already has decided on a structure for the new funding mechanism despite the lack of any supporting evidence on the record. The Commission based key elements of the mechanism on the recommendations in the Joint Board's Second Recommended Decision, but those recommendations were made without any supporting evidence in the record and the Commission has provided no other evidentiary support for those key elements. There is no factual support for the fundamental Commission assumption that a comparison of state-specific costs (over a to-be-determined geographic area) to nationwide average costs is a good measure of rate comparability.<sup>8</sup> Nor is there any factual evidence that a per line state "contribution" measures a state's ability to support rate comparability in high-cost areas. In fact, these proxies do not accurately or objectively reflect what they are supposed to measure.

The Commission's sole justification for using a threshold percentage differential between

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<sup>8</sup> Ameritech was the only commenting party that presented data on rates (add cite). Ameritech's data showed that some telephone companies that receive universal service funding have local rates that are far below the national average. Thus subsidies flow to these companies even though there can be no argument that the funds are needed to ensure rate affordability or comparability. Although the Ameritech data covered rural rather than non-rural LECs, the rural high cost fund is based on a comparison of company-specific costs to a nationwide cost average analogous to the proxy used in the mechanism in the Order. The Ameritech data certainly suggest that cost comparisons do not provide a good proxy for rate comparability.

area-specific forward-looking economic costs and nationwide average forward-looking economic costs is that the existing mechanism for providing universal service support for high-cost rural telephone companies uses a threshold percentage comparison of ILEC-specific embedded loop costs to nationwide average embedded loop costs. (Para. 98.) This is scant justification as the old mechanism was constructed using the same faulty analysis the Commission uses here: threshold percentage differentials were selected that would yield a pre-ordained fund-size that was not based on an objective subsidy needs assessment. As a result, the new fund, like the rural fund, would not be based on objective public policy principles that can provide reasonable guidance on how the fund should change over time. This creates a vacuum that allows future public policy to be held captive by “hold harmless” arguments of the sort the Commission has accepted in its Order. Moreover, it is inappropriate to treat the old approach as a precedent to follow because, in contrast to the current situation, the old high cost mechanism was the product of a cost separations rulemaking that was not attempting to implement a specific statutory mandate of Congress.

Perhaps ironically, in developing the proxy for “reasonably comparable rates,” the Commission explicitly rejects the revenue benchmark that it proposed in its initial order and substitutes a cost benchmark when calculating the support needed for rate comparability. But then in the portion of the mechanism that attempts to measure a state’s ability to support comparable rates, the Commission in effect re-introduces the revenue benchmark through use of a projected level of intrastate revenues per line that appears to serve as a measure of projected revenues when rates are affordable and comparable. But now instead of addressing rate affordability and comparability from the perspective of residential and small business customers,

as the Commission's original proposal did, this new funding mechanism addresses rate affordability and comparability from the perspective of incumbent providers. The focus on carriers inevitably will give rise to hold harmless protectionism at the expense of both consumers and competitors.

Moreover, there are basic questions, so far unasked, about the mechanism. For example, why doesn't the proxy for a state's ability to support rate comparability take into account the differences between business and residential lines, given that business lines will generate far more revenues and affordable business rates are higher than affordable residential rates?

#### **V. Key Parameters in the Commission Funding Mechanism Are Inherently Subjective**

The funding mechanism includes several variables that though quantifiable and therefore superficially appearing to be amenable to objective analysis, in fact do not lend themselves to such analysis and can only be breeding grounds for subjective, contentious argument both initially and over time as parties come in seeking modifications to reflect allegedly changed market conditions. The Commission must be prepared to respond to a few fundamental issues. (1) On what objective basis will the Commission determine the threshold percentage differential between geographic-specific costs and nationwide average costs that triggers the determination that rates in that geographic area are not reasonably comparable?<sup>9</sup> (2) On what objective basis will the

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<sup>9</sup> At para. 97, the Commission seeks further comment on the specific threshold percentage cost benchmark it should adopt and on whether the national benchmark should fall within the Joint Board's recommended range of 115 and 150 percent. The Commission apparently wants commenters to explain why, for example, a threshold trigger of 143 percent would yield a better estimate of the funding needed to ensure reasonably comparable rates than a threshold level of 127. At para. 99, the Commission encourages commenters to use updated model outputs in formulating their comments on the benchmark. But other than providing the resulting dollar figure, how does use of the model inform whether the chosen threshold value accurately measures reasonably comparable rates?

Commission determine the level or percentage of per line revenues that states can be expected to contribute toward funding rate comparability support?<sup>10</sup> (3) If these variable are not susceptible to objective public policy principles and analysis, of what use are they for public policy decision making? Unfortunately, the funding mechanism that incorporates these variables has already been identified as the foundation of a new subsidy scheme without any record evidence to show its use will yield a mechanism that meets the objectives and requirements of the Act.

**VI. The Structure of the Funding Mechanism Unnecessarily Builds in Subjectivity and Focuses on Providers Rather than Customers**

The structure of the funding mechanism unnecessarily builds in subjectivity. In its First Report and Order, the Commission got it right. It proposed that the level of universal service support needed to be explicitly and objectively identified and calculated first, and only then should the inherently subjective political decisions be made about the portion of the burden to be borne by each jurisdiction (and, if and where needed, about the additional interstate burden to support low tax base states). That approach has the added benefit that it focuses explicitly on the needs of high-cost customers. The first cut in determining the amount of support funding needed is a straightforward comparison of the costs of providing basic local service to high-cost customers to a revenue benchmark based on affordable and reasonably comparable rates. State- or carrier-specific needs are factored in only after the basic calculation is made.

In the mechanism under consideration, by contrast, subjective variables for which there are no objective criteria are embedded in the mechanisms that identify and calculate the level of

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<sup>10</sup> For example, on what basis can the Commission determine, nationwide, that each state can afford to contribute \$2 rather than \$3 toward maintaining reasonably comparable rates in the state?

universal service support needed. These do not focus on customer needs, but rather on arbitrary determinations of a state or carrier's ability to maintain reasonably comparable rates. Instead of using a mechanism that compares directly measurable variables — for example, the difference between the cost of serving a customer in a geographic area and a projected revenue stream generated by the average customer in that area if rates were set at affordable levels — the new mechanism incorporates indirect measures of nebulous parameters.

## **VII. Relative Costs Are Not a Good Proxy Measure of Comparable Rates**

By basing the measure of comparable rates on costs rather than actual rates, a state or carrier might be eligible for interstate subsidy funds intended to ensure comparable rates even if its rates were below the national average. As part of a comprehensive universal service reform package, it may be sensible to determine the proportion of interstate to intrastate funding by comparing costs across different states, for example, using the superbenchmark approach initially proposed by U S West. As part of the *ad hoc* approach put forth in this Order, however, the comparison of costs across states does not move rates and subsidies along a logical path to rate efficiency, comparability, and affordability. Some customers could be required to provide subsidies to other customers who currently pay below average rates. Thus, the Commission's mechanism does not provide any incentives or mechanisms to migrate rates that are below both costs and affordable levels toward levels that more closely approximate costs but are still affordable. Worse, the mechanism would hide these unnecessary subsidies from scrutiny by keeping them embedded in above-cost interstate and intrastate rates, rather than making them



explicit.<sup>11</sup> While it is true that states have jurisdiction over intrastate rates, it is perfectly consistent with federal law as well as good public policy to deny a state access to subsidies intended to ensure rate comparability if rates in that state are set below a national average rate.<sup>12</sup>

#### **VIII. The Funding Mechanism Does Not Provide a Framework to Transition to Competition or Eliminate Implicit Subsidies**

The Order focuses on identifying “support levels that are sufficient to enable reasonably comparable rates, in light of current levels of competition,”<sup>13</sup> but provides no objective, analytical tool for determining how support levels should change if effective competition actually develops that erodes implicit subsidies. States and carriers inevitably will seek modification of the fund to reflect alleged competitive changes that in turn affect the amount of implicit intrastate funding allegedly available for support, but the proposal provides no objective means for analyzing such

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<sup>11</sup> On one hand, to the extent unnecessary subsidies are maintained, it is better to keep them in rates that might be eroded by competition than to place them in an explicit support fund that is insulated from competition. On the other hand — and this seems to trump the former — it is easier to maintain unnecessary subsidies if the subsidy remains undefined and is hidden in rates.

<sup>12</sup> It appears from the Order, that the Commission may be motivated by a desire to steer clear of any issues involving intrastate rates. By defining rate comparability on costs rather than rates, it avoids such issues as “value of service” pricing, whose advocates argue that since customers located in rural exchanges can reach fewer parties with their local service than customers located in urban exchanges can, “comparable” rates for rural service should be lower than for urban service, despite significantly higher costs. In a related fashion, some parties have argued that the comparable rates requirement should apply not just to basic local residential and small business rates, but also to access charges and toll rates. The Commission attempts to finesse these issues, but given that creation of an explicit interstate universal service fund without dollar for dollar reductions in interstate access charges imposes a real cost burden on interexchange customers and on customers in payor states, it is not appropriate or lawful to fail to identify how rates will be adjusted at the time universal service reform is implemented..

<sup>13</sup> Order at para. 99.

requests and modifying the funds.<sup>14</sup>

If competition develops that erodes the profit margins in intrastate services, then other things being equal the level of revenues per line that states can be expected to contribute toward rate comparability can be expected to fall. But profit margin information is not directly available; only rates are available. And rate reductions may reflect cost reductions as well as profit margin reductions, so a full evaluation of how competition affects a state or carrier's ability to contribute to the fund could virtually require a full cost proceeding — an expensive, cumbersome, time-consuming, and unnecessary result. The Commission itself indicates that the funding calculation may have to change as competition develops. The problem is that the Commission's proposed mechanism cannot handle such change.

Moreover, the Order and Further Notice provides no guidance on how to quantify the amount of implicit universal service subsidy funds embedded in interstate access charges that must be replaced by explicit funds. By resolutely avoiding any calculation of the actual total universal service subsidy needed to meet the statutory objectives of rate affordability and comparability, and instead backing into a "solution" by seeking input values for irrelevant variables that will provide some pre-ordained short-term funding level, the Commission has no objective basis on which to determine how much implicit universal service funding is embedded in interstate access charges. The Commission has indicated that it will address the removal of implicit universal service subsidies from interstate access charges in a separate proceeding. But absent any systematic

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<sup>14</sup> To complicate matters, in the mechanism, the advent of greater competition could affect both the proxy for rate comparability (if the geographic area in which the cost calculation were made more granular to better reflect underlying costs) and the proxy for the state's ability to fund the rate comparability support (if states or carriers claimed that the per line contribution should be decreased to reflect competition-induced lower per line profit margins).

definition and calculation of universal services needs, the Commission will not have the ability to do so in an objective fashion.

This leaves industry in general, and the interexchange carriers in particular, in a particularly precarious position. First, there is no way to project what the future universal service burden will be. Second, there is no guidance on whether and by how much implicit subsidies will be removed from interstate access charges as an explicit fund is implemented.<sup>15</sup>

#### **IX. A “Hold Harmless” Policy Will Undermine Competitive Neutrality**

The Commission asks for comment on incorporating a hold harmless clause that would ensure that no state and/or carrier would obtain less universal service funding under the new mechanism than it does currently. Any hold harmless clause will undermine competition by artificially favoring incumbents. If a carrier were held harmless, then it would continue to receive the same level of universal service funding even if it were no longer serving all the high-cost customers whose rates the universal service fund was intended to keep affordable and comparable. At the extreme, it could continue to receive funding even if it no longer served any high-cost customers. Even if CLECs only manage to capture a few high-cost customers, and thus the unearned subsidy flow to the incumbent is relatively small, it is not competitively-neutral for one competitor to receive subsidies because of a grandfathered monopoly position that others could not attain. Moreover, if incumbents continue to receive funding when they no longer serve some high-cost customers, then clearly the funding would not be used “only for the provision, maintenance, or upgrading of facilities and services for which the support was intended,” as

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<sup>15</sup> It appears that explicit fund would be in addition to the funding mechanism to support reasonably comparable rates.

required by Section 254(e) of the Act.

The distorting and discriminatory impact of a hold harmless clause would be smaller if the entity held harmless was the state, but even here there would be significant problems that weigh strongly against such a clause unless the clause explicitly requires that the funds be disbursed in a competitively neutral fashion and has some teeth to enforce this requirement.

In addition to undermining competitive neutrality, a hold harmless provision would collect more universal service funding than is actually needed and thus would add an unnecessary burden to those who contribute to the fund, and ultimately end users.

One question in the Further Notice demonstrates the hollowness of the hold harmless concept. The Commission asks (at para. 122) if a new entrant were to win a high cost customer from an ILEC, should the new entrant receive the incumbent's hold harmless support or the lower amount of support determined on a forward-looking cost basis. Of course, there is no reason for the competitor to receive more subsidy funds than needed to cover forward-looking costs. And there also is no reason for the incumbent to receive more subsidy funds than needed to cover forward-looking costs. Hold harmless funding provides an unwarranted windfall to incumbent LECs.

**X. The Choice of Geographic Area Will Have Unintended Significant Impacts on Competitive Neutrality, Efficient Investment Decisions, and Targeting Universal Service Funds**

The Commission seeks comment (at para. 102) on whether the interstate support mechanism should calculate support levels by comparing the forward-looking costs of providing supported services to the benchmark at either (1) the wire center level; (2) the unbundled network element (UNE) cost zone level; or (3) the study area level.

The Order correctly states (at para. 103) that calculating costs at a granular (e.g., wire center) level ensures that there will be sufficient support for high-cost customers if implicit subsidies are eroded by competition, ensures that the subsidy will be portable by not keeping any of it embedded in incumbents' rates, targets support to high cost subscribers, and encourages efficient competitive entry in all areas. For these reasons, MCI WorldCom has supported granular cost calculations.

There can be substantial drawbacks to granular costing, however, if it is not accompanied by the comprehensive reforms in access and UNE pricing envisioned in the Act. If an explicit universal service fund is created based on deaveraged costs, but rates for unbundled loops are set at averaged rates that forestall competition and the implicit subsidies are not removed from interstate access charges, then the result will be that impediments to entry are maintained, ILECs are able to double-recover universal service subsidies, and new entrants and interexchange carriers (and their customers) will foot the tab for this double payment. In this case, doing what is ostensibly the right thing could result in anticonsumer and anticompetitive distortions that outweigh the potential benefits.

If costs — and therefore the size of the subsidy required — were calculated at the study area level, the explicit fund created would not be large enough to fund all universal service needs; some implicit subsidy funds would still be needed. The limited explicit funding should be targeted to the highest cost areas by distributing the funding on a pro-rata basis to the providers serving customers in the highest cost areas. This could best be done by using the Commission's synthesis model to identify costs in all areas and then applying the explicit funds to the highest cost customers first. For example, if a state had residents in four cost zones whom it would cost \$20,

\$40, \$60, and \$80 per month to serve, it should first apply the explicit funds to those customers with costs exceeding \$80 to get the remaining costs down to \$60. If funds remained, it should apply the explicit funds to those customers with costs of \$60 (both those whose costs originally were \$60 and those whose costs originally were \$80 but already received the subsidy), to get the remaining costs down to \$40, and so forth until the explicit fund were exhausted. This would ensure that funding was targeted to the highest cost customers.

**XI. In the Absence of Comprehensive Universal Service and Access Charge Reform, Partial Steps Should Be Taken to Remove Implicit Universal Service Subsidies from Interstate Access Charges, Starting with Carrier Common Line Charges**

The Commission seeks comment on how to adjust interstate access charges to account for explicit support. Pursuant to the high cost universal service funding mechanism under discussion, it is impossible to identify the total universal service subsidy needed or what portion of that currently is embedded in interstate access charges. Factual information therefore is not available to provide a basis for determining how to adjust interstate access charges to account for explicit support. The Commission has created a fact-free environment in which it will be able to justify any course it chooses and thus it will be able to pre-judge, without any evidence, the amount of implicit universal service subsidies in interstate access charges. Given the funding mechanism in the Order, comprehensive universal service and access reform cannot be achieved.

Nonetheless, partial steps can and should be taken to remove implicit universal service subsidies from access charges. At the least, the Commission should look at any past proceedings that may provide guidance on the level of implicit subsidies in interstate access charges. Reductions should come first from the carrier common line charge, then if additional reductions are called for, from the PICC. Initial reductions should not be made to the base factor portion

(BFP).

**XII. Simulations Show That Commission's Model Is a Blunt, Inflexible, Instrument, Incapable of Achieving its Stated Goals in a Rational Manner**

The Commission asked parties to perform runs of its cost model to determine what the appropriate input values should be for the funding mechanism variables. As indicated earlier, MCI WorldCom does not believe the values chosen for key input variables have any substantive meaning. But the values chosen will affect the size of the fund. The choice of the threshold cost differential percentage has a large impact on fund size; the choice of level or percentage of revenues per line that states can be expected to contribute toward rate comparability has a smaller, but still significant, impact on fund size. There are two other factors that have a very large impact on fund size: (1) the choice of geographic area over which to perform the cost calculations, and (2) whether the cost calculations are performed state-wide or carrier by carrier. Holding everything else equal, shifting from a state-wide average to a company-wide average, or from a state-wide average to cost-zone calculations, will increase fund size by at least a factor of 3.5 or more. These factors affect fund size because they represent greater or lesser cost averaging or, put another way, maintaining greater or lesser levels of implicit universal service support. By contrast, the shifting the value of the threshold cost differential percentage from one extreme of the range proposed by Commission (160 percent) to the other extreme (115 percent), results in about a four-fold increase in fund size. At the same time, halving the per line state contribution (from \$2 to \$1) only increases the federal fund size by about 10 to 20 percent.

If the Commission wants to limit the increase in fund size, to be consistent with its finding in the Order that under current market conditions and rates there is no affordability problem and

comparability needs are small, then it must perform the funding calculations using state-wide averages across all companies and must set the threshold cost differential percentage fairly high. The only variable that is not incredibly blunt is the per line state contribution. Moreover, if the fund were kept relatively small, it might well result in only two states — Mississippi and West Virginia — receiving additional funds. They would receive very substantial funding increases.


### **XIII. Conclusion**

In this Order and Further Notice the Commission has failed to properly comply with statutory requirements to develop support mechanisms that are specific, predictable, and sufficient and which ensure that consumers in high cost areas have access to telecommunications services at rates that are affordable and reasonably comparable to rates charged for similar services in urban areas. First, the Order and Further Notice fail to identify the extent to which local rates have been kept affordable due to implicit subsidies in interstate access charges. Second, the Order fails to properly measure comparable rates. Third, the Order and Further Notice fail to properly measure a state's ability to respond to the possibility that competitive forces will threaten existing rate comparability. Finally, the Order's "hold harmless" provisions violate Section 254(e) of the Act. The Commission must rectify its errors. It should use the Further Notice part of the proceeding to: 1) establish a record that defines the total universal service subsidy needed to maintain affordable rates, and then use that definition to determine the maximum size of explicit universal service support; 2) establish a record that examines the reliability and feasibility of its measure, and alternate measures, of comparable rates; 3) establish a record that examines the relation between competition, rate comparability, and state revenue generation; and 4) eliminate hold harmless mechanisms from its Final Order.



### Statement of Verification

I have read the foregoing and, to the best of my knowledge, information and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on July 23, 1999.



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I, Carolyn McTaw, do hereby certify that on this 23rd day of July, 1999, I caused a copy of the foregoing Comments of MCI WorldCom, Inc, to be served upon each of the parties listed on the attached Service List by U.S. First Class mail, postage prepaid.

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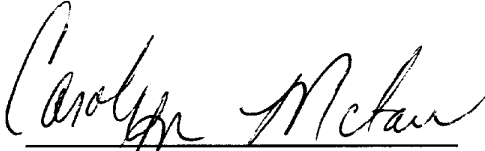
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